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Mr Andreas Barckow, Chair
International Accounting Standards Board
Columbus Building 7
Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

18 July 2023
602/636

Dear Mr Barckow

Re.: IASB Exposure Draft – Amendments to the Classification and Measurement of Financial Instruments

The IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.)[1] would like to thank you for the opportunity to comment on the IASB's Exposure Draft (ED) *'Amendments to the Classification and Measurement of Financial Instruments – Proposed amendments to IFRS 9 and IFRS 7'.*

We very much welcome the IASB's response to feedback from various stakeholders (ourselves included[2]) from the Post-Implementation Review (PIR) of IFRS 9 *Financial Instruments (Phase 1: Classification and Measurement)* with this ED to address application issues related to the assessment of the contractual cash flow characteristics of financial assets in a timely manner. In this context, clarifying the accounting treatment of financial instruments with cash flows linked to environmental, social and governance-related features (ESG-linked instruments) is of particular importance, as their prevalence and diversity has increased significantly worldwide in recent years. Currently, payments that vary in accordance with ESG-linked features do not fit well with IFRS 9's guidance on

[1] The IDW is a voluntary membership organisation representing the interests of the profession of public auditors in Germany and counts over 83 % of this profession as members.

[2] We refer to the IDW comments on the IASB Request for Information: Post-implementation Review, IFRS 9 *Financial Instruments* – Classification and Measurement from 27 January 2022.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann, WP StB, Sprecher des Vorstands;
Melanie Sack, WP StB, stv. Sprecherin des Vorstands;
Dr. Torsten Moser, WP

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cash flow characteristics, since at the time this was developed such financial instruments were not prevalent. This situation has changed dramatically in recent years and is expected to change into the foreseeable future.

The IDW generally welcomes the IASB's principles-based approach in providing additional application guidance on assessing whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, including the particular focus, on assessing whether the contractual terms are consistent with a basic lending arrangement.

However, we are not completely convinced by the proposed additional application guidance. Firstly, because these proposals introduce new terms and criteria into the existing concept of IFRS 9, they will present some significant challenges in interpretation and application for preparers, auditors and other stakeholders. Secondly, rather than just providing clarification, we believe that the proposed new paragraphs B4.1.8A and B4.1.10A will also amend the current approach to assessing the cash flow characteristics of financial assets. Consequentially this may give rise to changes (which cannot entirely be anticipated in advance) to the previous classification of certain financial assets, which we believe was not the intention of the IASB when proposing the amendments. Moreover, we believe that the proposals are likely to result in the recognition of more financial assets (not only ESG-linked instruments) at amortised cost in the future. In this context, we welcome the Board's decision to include 'Amortised Cost Measurement' in its research project pipeline.

Given the aforementioned issues, we simply want to point out that if such a potential change to the current practice of classifying and measuring different types of financial assets is not desired, the IASB should reconsider introducing specific rules for dealing with ESG-linked instruments instead of supplementing or amending existing rules that are now established in practice (fallback solution). In order to achieve a consistent and workable solution, this decision needs to be made taking into account feedback from extensive outreach activities and cost-benefit considerations for both approaches.

Finally, we would like to reiterate our view that the issues addressed in this ED regarding the classification and measurement of financial assets (particularly ESG-linked instruments) are of great importance and urgency. For this reason, we would urge the IASB to direct its resources and focus towards finalising these key aspects first, such that – in case there are capacity restrictions when finalising the amendments – the other issues also raised in this ED may be dealt with at a later stage.

Further, we would like to comment on the specific questions of the ED as follows:

Question 1: Derecognition of a financial liability settled through electronic transfer

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

In regard to the cross-reference of paragraph B3.1.2A to paragraph B3.1.6 of IFRS 9, we would like to point out that paragraph B3.1.6 of IFRS 9 describes settlement date accounting only for financial assets. Specific material on settlement date accounting for the recognition and derecognition of financial liabilities would therefore need to be added.

Further we acknowledge the proposal to permit derecognition of financial liabilities before the settlement date when specified criteria are met. However, from our point of view, further additions and clarification would be desirable:

- Firstly, the request to the IFRS Interpretations Committee (IC) concerned the application of IFRS 9 in relation to the recognition of cash received by an entity by electronic transfer in settlement of a financial asset (i.e., a trade receivable). We welcomed the decision of the IFRS IC, in response to the feedback received on the tentative agenda decision, to refer the matter to the IASB in the expectation that stakeholders' concerns will be addressed in a narrow-scope standard-setting process. As the IASB could not identify any fundamental problems with the clarity and suitability of the derecognition requirements in IFRS 9 as a result of the PIR, it decided to address issue of cash settlement with electronic payment systems in a narrow-scope standard-setting project. Now, however, we question why the current discussion completely excludes the asset side of the statement of financial position as, the request originally addressed to the IFRS IC remains unanswered. Moreover, the question arises as to whether the IASB has deliberately refrained from developing a consistent

regulation for the settling of financial assets and financial liabilities using electronic payment systems and from addressing potential asymmetry or timing mismatches between the derecognition of financial assets and financial liabilities (which is especially challenging for intercompany payables and receivables). At least an explanation of the reasons for this decision would be useful.

- With the introduction of paragraph B3.3.8 of the ED, the IASB would create a rule-based but at the same time pragmatic exception to the basic principle of derecognition of financial liabilities in IFRS 9. It applies only to the case when a comparatively long period of time is needed for payment processing by means of an electronic payment system. For most payment systems used in the EU/EEA, the processing time is so short that this problem does not arise, so the proposed exception is unnecessary.
- The proposed exception to derecognise financial liabilities before the settlement date introduces new terms and criteria which, in our opinion, require further clarification in order to avoid misinterpretation and problems in application in practice, for example:
  - There is no definition of an 'electronic payment system' and thus it is unclear what kind of means of payment fall within the scope of the amendment.
  - It is also unclear what is considered as a 'short time' between the initiation of a payment instruction and the delivery of cash. The assessment would become more operable if 'short time' were clarified as the time needed to execute the electronic payment process.
  - The new term 'settlement risk' should not (only) be explained in the Basis for Conclusions (we refer to paragraphs BC33 et seq.). We recommend a relevant definition of this term be included in Appendix A of IFRS 9.
- Furthermore, we would suggest the IASB clarify the entry on the credit side needed when the exception according to paragraph B3.3.8 is used and, as a result, the financial liability is derecognised before the settlement date. In our opinion, it is unclear whether (1) the cash must be derecognised at the same time as the financial liability or (2) another liability can be recognised at the same time as the financial liability is derecognised. For this reason, we recommend the Board explicitly state that

when the financial liability is derecognised, the corresponding entry is against cash – provided all criteria for the exception are met. For the avoidance of doubt, we assume that 'cash' may also include bank overdrafts as those are included as a component of cash and cash equivalents in accordance with paragraph 7 of IAS 7.

Question 2: Classification of financial assets – contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

a) interest for the purposes of applying paragraph B4.1.7A; and

b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

The IDW welcomes the IASB's efforts to develop a solution for the accounting treatment of new kinds of financial instruments (i.e., financial assets with ESG-linked features), which were neither significantly prevalent nor widespread at the time IFRS 9 was developed.

In our view, there are two alternative approaches for the Board to follow:

1) principles-based approach or
2) a rule-based addition or exemption in IFRS 9.

The IDW explicitly supports the development of principles-based standards. Accordingly, we generally support the development of principles-based requirements for the classification and measurement of financial assets in accordance with IFRS 9.

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In assessing whether contractual cash flows of a financial asset are solely payments of principal and interest on the principal amount outstanding and are therefore consistent with a basic lending arrangement (we refer to paragraph B4.1.7A), a principles-based approach would require the term 'basic lending arrangement' being clearly defined.

In this context, the proposals in the ED on the *elements of interest a basic lending arrangement* are not completely convincing in this respect. While we welcome the clarifications on the concept of 'basic lending arrangement' in paragraph BC47 of the ED, the new application guidance in paragraph B4.1.8A of the ED raises some questions:

- *The assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives.*

  The IDW recognises the rationale already contained in paragraph BC4.182(b) of IFRS 9 that different elements of interest should be considered separately and that what an entity is being compensated for is more crucial than the amount. However, we recommend the wording be clarified so as not to imply an ability to completely refrain from considering the amount of compensation in cases of variability in contractual cash flows. In point of fact, an assessment of the 'how much' is inherently required in order to assess leverage. This could also help avoid potential inconsistent interpretations of the last sentence of paragraph B4.1.8A of the ED.

- *Further, a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs.*

  As the Board is introducing a new concept here, further application guidance and/or examples for implementation purposes would be helpful. In particular interpretations of the term 'magnitude' could lead to considerable uncertainty. This seems to be all the more true as we believe that this requirement is already covered by the concept of 'leverage' in paragraph B4.1.9 of IFRS 9, which is commonly used for classification purposes.

Our further comments concern the proposed guidance on *contractual terms that change the timing or amount of contractual cash flows* (in particular the new paragraph B4.1.10A of the ED):

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- *… an entity shall assess whether contractually specified changes in cash flows following the occurrence (or non-occurrence) of any contingent event …*

  The IDW appreciates the IASB's clarification that for the purpose of assessing whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding, *all* variability in contractual cash flows over the life of an instrument should be considered and not only those resulting from one of the elements of interest specified in paragraph B4.1.7A of IFRS 9.

- *For a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor.*

  While we consider that 'specific to the debtor' is a typical feature of ESG-linked instruments, we do not consider it an appropriate criterion for defining a basic lending arrangement. In particular, the IDW does not agree with paragraph BC67 of the ED. Accordingly, any change in contractual cash flows due to a contingent event that is specific to the creditor, or another party would be inconsistent with a basic lending arrangement. In our view, the comparison with the definition of a derivative under IFRS 9 in this paragraph seems to be questionable. Moreover, we are concerned as to potential unintended consequences for current accounting practices. As we believe it was not the IASB's intention to address or change the current accounting for financial assets subject to such contingent events, but rather to focus on contingent events that are specific to the debtor, we strongly recommend that the IASB clarify this perceived intention is indeed its intention and reflect this in the wording used in the BC in order to avoid unintended consequences.

- *… the resulting contractual cash flows must represent neither an investment in the debtor nor an exposure to the performance of specified assets …*

  The term 'investment in the debtor' is undefined and broad and should therefore be explained more in detail. Further clarification of, and illustrative examples to support the criterion 'exposure to the performance of specified assets' would also be useful. In general, adding more complex examples that would also demonstrate the boundaries of the new requirements formulated in the ED would be helpful.

We believe that the IASB's proposals regarding the classification and measurement of financial assets will pose some significant interpretation and application challenges for preparers, auditors and users, as they include not only clarifications but also some entirely new criteria for assessing whether contractual cash flows are solely payments of principal and interest on outstanding principal. Consequently, these proposals can be expected to change the existing concept of classification of financial assets under IFRS 9 to some extent.

This fact should be clearly communicated by the Board, as well as the consequence that the proposals may lead to changes to the previous classification of certain financial assets, which cannot be fully assessed in advance. For this reason, the proposed transition disclosure requirements in paragraph 7.2.49 are relevant and useful, as they make the changes in the classification of existing financial assets visible (we refer to our answer to Q7).

Further, in our view, the proposed amendments to the classification and measurement of financial assets are likely to result in the recognition of more financial assets (not only ESG-linked instruments) at amortised cost in the future. In this context, we welcome the Board's decision to include 'Amortised Cost Measurement' in its research project pipeline. In our experience, issues concerning the differentiation between the application of paragraphs B5.4.5 and B5.4.6 are of considerable practical relevance. Therefore, we recommend that the IASB prioritise this project, as such issues will become even more prevalent once the proposed amendments become applicable.

If the IASB does not intend such a potential change to the current practice of classifying and measuring different types of financial assets, it should consider the introduction of specific rules for dealing with ESG-linked instruments rather than supplementing or amending the existing rules that are now established in practice (fallback solution). We are aware that this approach would not only contradict the overarching goal of developing a fundamentally principles-based standard but would also bring its own challenges. For example, a definition of 'ESG-linked' would need to be developed. In this respect, however, the Board could build on taxonomies that already exist.

Finally, we would like to point out that the ED's proposals on the classification and measurement of financial instruments relate exclusively to financial assets and thus to the asset side of the statement of financial position. However, there are several ESG-linked financial liabilities that need to be assessed, particularly regarding whether they contain an embedded derivative and, if so, whether this derivative needs to be separated from the host contract. In this context, we would welcome a clarification of the definition of a derivative, which the IASB

has already considered in another context, in particular what is meant by a 'non-financial variable that is not specific to a counterparty'.

Question 3: Classification of financial assets – financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

The IDW welcomes both the Board's decision to consider 'non-recourse' as a feature of certain financial assets, rather than a separate category of financial assets, and the proposed application guidance to describe a non-recourse feature (we refer to paragraph B4.1.16A of the ED).

In addition, we believe that the examples of the factors an entity needs to assess in determining whether the contractual cash flows of a financial asset with non-recourse features are payments of principal and interest on the principal amount outstanding are helpful.

Question 4: Classification of financial assets – contractually linked instruments

The draft amendments to paragraphs B4.1.20-B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21-B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We welcome the IASB responding to the feedback from the PIR and that it proposes to describe investments in contractually linked instruments in more detail.

The IDW generally agrees with the proposed application guidance, as it provide more clarity on this specific types of transaction. Among other things, we appreciate that waterfall payment structures are now mentioned explicitly in the application guidance.

We only disagree with the proposed paragraph B4.1.20A of the ED, as the example given therein, and the conclusion drawn from it seem misleading and inappropriate. For example, in the case where a sponsor initially holds a junior debt instrument, which it later sells, the application of the requirements for contractually linked instruments could be avoided because the test of whether contractual cash flows represent solely payments of principal and interest on the principal amount outstanding is only applied at initial recognition. We therefore recommend deleting the proposed paragraph B4.1.20A of the ED.

Finally, we would like to point out that despite the proposed additional application guidance, there are still some open questions, as outlined below. If the IASB decides to develop the amendments separately it would be helpful to address these questions i.e., only if addressing them would not delay the finalisation of the other proposed amendments. These open questions include:

- What is the definition of a 'tranche'?
- How are tranches to be distinguished from each other?
- What happens when individual tranches are sold?
- What happens if real estate loans are collateralised, the collateral takes effect, and the property is thereby included in the pool?

Question 5: Disclosures – investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and

b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with the proposed disclosures requirements.

Question 6: Disclosures – contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

The IDW agrees with proposed disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event in accordance with paragraph 20B of the ED. We believe that these disclosures for financial assets that meet

the criteria in paragraph B4.1.10A of the ED will result in more transparency and decision-useful information for users of financial statements.

However, we would like to note that the proposed disclosures for *all* financial instruments would lead to a significant increase in data collection for preparers. Consequently, preparers would need to make significant adjustments to their IT systems to collect the information required for the disclosures and to track the information for each class of financial asset or financial liability. Given the large volume and diversity of financial instruments, the IDW believes that the proposed disclosure requirements could pose significant operational challenges and thus increase the implementation costs for both holders and issuers.

For this reason, we recommend limiting the disclosures under paragraph 20B to financial *assets* that meet the criteria in paragraph B4.1.10A of the ED. In our view, paragraph 20C of the ED should be deleted altogether after paragraph 20B has been amended to refer to classes of financial instruments.

Question 7: Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with the transitional provisions proposed in the ED for both the amendments to IFRS 9 and IFRS 7.

Further, we agree with the proposed disclosure requirements in paragraph 7.2.49 of the ED as they provide useful information on the effect of the proposed amendments to the classification and measurement of financial assets. However, the need for disclosure requirements in the case that the measurement category of financial assets has changed as a result of the proposed amendments in this ED is, in our opinion, a further indication that these proposals are not only clarifications of the existing concept, but also amendments that may

lead to potential changes to the previous classification of certain financial assets; changes that cannot be fully assessed in advance. This fact should be clearly communicated by the Board. (In this context, we refer to our answer to Q2.)

Finally, as already mentioned above, we consider the proposed amendments on the contractual cash flows characteristics to be the most important and urgent issues addressed by this ED. For this reason, we would welcome the IASB to press for their early review and finalisation. For entities to be able to apply these changes as early as possible, individual transitional provisions should be considered.

We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you.

Yours sincerely

Bernd Stibi	Kerstin Klinner
Technical Director	Senior Technical Manager
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